82-1195

Supreme Court, U.S.
FILED
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ALEXANDER L. STEVAS
CLERK

No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

DALE F. MEYER,
on behalf of himself and
all others similarly situated,
Petitioner,

vs.

THOMSON & MCKINNON AUCHINCLOSS KOHLMEYER, INC.,
UCA SYSTEMS, INC., JAMES L. MILLER,
and GERALD P. KOOYERS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

Whether investment in a managed commodity futures trading program based on a proprietary computer selection formula and marketed to the general public through a brokerage firm may involve the sale of an investment contract, and therefore of a security, within the meaning of and subject to the registration requirements of the Securities Act of 1933.

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and GERALD P. KOOYERS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Dale F. Meyer, on behalf of himself and all others similarly situated, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the District Court for the Northern District of California (App. A) was not published. The opinion of the court of appeals (App. B) is reported at 686 F.2d 818.

STATUTES INVOLVED

The relevant provisions of Sections 2 and 5 of the Securities Act of 1933 (15 U.S.C. §§ 77b(1) and 77e(c)) are set forth in the Appendix (App. E).

JURISDICTION

The judgment of the court of appeals was entered on September 9, 1982. (App. C). By order dated November 17, 1982, Mr. Justice Rehnquist extended the time within which petitioner could file a petition for writ of certiorari to and including January 14, 1983. (App. D).

STATEMENT OF THE CASE

This case was decided on undisputed facts:

Respondent Thomson McKinnon Securities, Inc., a Delaware corporation with its principal place of business in New York City, engages in business as a securities broker-dealer and commodities trader. Respondent James L. Miller was employed by Thomson McKinnon in its Palo Alto, California office as an account executive having direct contact with the public (R. 36, interrogatory # 3).[1]

Respondent UCA Systems, Inc. is a California corporation wholly owned by respondent Gerald P. Kooyers (R. 24, interrogatories # 1(a) and 3). UCA developed a systematic, computerized scheme for trading commodity futures.

Together, respondents publicly offered and sold investments in managed commodity futures trading accounts. Petitioner, a high school janitor making $600.00 per month, was persuaded by Thomson McKinnon, through Miller, to

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[1] "R." refers to the original record filed in the court of appeals.

invest some $40,000 in respondents' scheme whereby the funds would be deposited with Thomson McKinnon, who would execute the trades based on the computerized signals generated by UCA's selection formula. Pursuant to respondents' scheme, UCA would ". . . cause commodity contracts to be bought, sold, sold short, and spread, and will have exclusive authority to issue all other necessary instructions to the broker." (R. 59, deposition of Meyer, Vol. 2, Ex. 6, p. 12 ¶ 2.)

Thomson McKinnon was paid commissions on a per trade basis and earned $1,848 in commissions in less than three months (R. 24, Ex. A to UCA's answers, etc., to plaintiff's first set of interrogatories). UCA determined the trades in all accounts it was managing by use of the "Statistical Qualifier System" it had developed and was paid a fee of 6% of the managed assets every three months, or 24% per year (R. 59, deposition of Meyer, Vol. 2, Ex. 6, p. 12 ¶¶ 4, 8). All the accounts managed by UCA were traded uniformly based on these computerized signals. In each account, the investor remained passive.

Respondents describe their methodology as follows:

> The Statistical Qualifier System is a unique approach for the speculative trading of commodity futures. It is based on the premise that although commodity price movements tend to be largely random in nature, significant trends originate in these random action patterns, and can be identified as they emerge. Since, fundamentally, economic pressures are the motivating forces behind commodity price movements in the long run, a statistical discriminator is used to filter out the signals of random action, and identify significant price movements. [R. 59, deposition of Meyer, Vol. 2, Ex. 6, p. 6.]

REASONS FOR GRANTING THE PETITION

The decision below, holding that a managed commodity futures trading account is as a matter of law not a "security" under the Securities Act of 1933, squarely conflicts with *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974), and is not consistent with the conclusion of this Court in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946). The definition of a security for purposes of federal securities law, in this and other contexts, has occasioned increasing conflict and confusion among the lower federal courts, and should be clarified by this Court in the interest of the proper and uniform application of the federal securities laws and the removal of unnecessary litigation from the federal courts. Such a clarification, drawing on the insights of modern finance theory, is clearly feasible, and will provide the badly needed guidance this important question warrants.

1. As formulated by this Court in *Howey*, the test of an investment contract is "whether the scheme involves an investment of money in a common enterprise with profits to come solely with the efforts of others" (328 U.S. at 301). Not surprisingly, every element of that definition has subsequently received close scrutiny and elaboration. The only element that the court below found lacking in the instant case was the existence of a common enterprise.

Two lines of approach to the definition of a common enterprise have evolved in the cases. Some courts have demanded that the scheme exhibit "horizontal commonality"—a pooling of the capital contributed by investors in the way the venture is operated, usually accompanied by a pro-rata sharing of the residual profits (if an equity in-

vestment) or promised return (if debt). See, e.g., *Wasnovic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D.Pa. 1972), aff'd mem., 491 F.2d 752 (3d Cir. 1973), cert. denied, 416 U.S. 994 (1974); *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216 (6th Cir. 1980), aff'd on other grounds, ... U.S. ....., 102 S.Ct. 1825 (1982); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977). The typical business corporation issuing common stock or debentures clearly meets a horizontal commonality test.

But other courts have held that, in the absence of such a pooling, the common enterprise requirement may be satisfied by something else: "vertical commonality", in the sense of some species of common venture between the investors and the promoter in which different investors may be differently affected. There is disagreement, however, over the nature of the relationship between promoter and investor which is needed. The Fifth Circuit looks to whether the outcomes for the individual investors, though they may vary in some respects and are not pro-rata equivalents, nonetheless have in common the fact that they are essentially determined by the promoter's expertise and efforts which are applied uniformly to all accounts. See *SEC v. Koscot Interplanetary*, 497 F.2d 473, 478 (5th Cir. 1974); *SEC v. Continental Commodities Corp.*, 497 F.2d 516, 522 (5th Cir. 1974). The Ninth Circuit, on the other hand, requires that, to have a common enterprise, the promoter must share directly in the individual investors' profits and losses; it is not enough that the promoter's business and income will be affected generally by how well his investor clients do. See *Brodt v. Bache & Co., Inc.*, 595 F.2d 459 (9th Cir. 1978); *Mordaunt v. Incomco*, 686 F.2d 815 (9th Cir. 1982).

As applied to managed commodity futures trading accounts, these divergent views have led to their being held securities by the Fifth Circuit because "the success of the trading enterprise as a whole and customer investments individually is contingent upon the sagacious investment counseling of Continental Commodities" (497 F.2d at 522), and being held not to be securities by the Ninth Circuit because "Bache could reap large commissions for itself and be characterized as successful, while the individual accounts could be wiped out" (595 F.2d at 461).

Not only does the Ninth Circuit's view, as applied once more to sustain the dismissal of petitioner's complaint, conflict with the holding of the Fifth Circuit, it is also inconsistent with the basic *Howey* decision of this Court. In *Howey,* an orchard operator sold off title to individual groves of citrus trees to individual investors, offering at the same time a servicing contract to tend the groves and harvest and market the fruit; the arrangement was held to constitute an investment contract, and hence the sale of an unregistered security. The stipulated facts in *Howey,* set forth in the opinion of court of appeals below, make it clear that this Court's finding of a common enterprise was not predicated on the existence of what is now termed "horizontal" commonality, nor on "vertical" commonality by the Ninth Circuit's standard, but instead on a reading consistent with the Fifth Circuit's interpretation. *SEC v. W. J. Howey Co.,* 151 F.2d 714 (5th Cir. 1945).

To quote from the stipulated facts: "In the care of each grove, as in the yield of the fruit, the cost of the care and the proceeds of [the sale of] the fruit may be, and are, definitely and distinctly accounted for with respect to the specific property owned by the individual." (151 F.2d at

716 n.5). The point was further highlighted in the opinion text: "Here it is quite clear that each purchaser looked for the income from his investment to the fruitage of his own grove and not to the fruitage of the groves as a whole. It is quite clear, too, that each purchaser's income was in no sense dependent upon the purchase or development of other tracts than his own except in the sense that as grove owners generally prospered, each owner of a grove would." (151 F.2d at 717).

In *Howey*, it is evident, investors did not have an undivided or pooled interest in the residual profits of the entire orchard; horizontal commonality was lacking. Likewise, the promoter would derive income from servicing fees and marketing charges, regardless of whether the grove owner made a lot of money or none at all; vertical commonality by the Ninth Circuit's test was lacking. But this Court held that the overall management supplied by the promoter was necessary to the feasibility of the operation and sufficient (in conjunction with the other elements) to constitute a common enterprise.

In sum, the court of appeals' decision in this case is in conflict with the holdings of the Fifth Circuit and with the foundation for this Court's decision in *Howey*. Respondents have together publicly offered opportunities to invest in commodity trading accounts, uniformly managed in accordance with a unique and vaunted computer trading program; there was a common enterprise, in the *Howey* sense. This Court should resolve the conflict among the circuits, and dispel the confusion over the meaning of the common enterprise requirement, which goes to the heart of the most basic concept in the application of the federal securities laws.

2. Even more fundamentally, there is pressing need for a reconsideration and clarification of the "security" definition as a whole. Lower courts have exhibited substantial uncertainty and conflict over the proper scope of coverage of the federal securities laws, outside of the central core area of a business corporation issuing stock or debt to the investing public. Some examples follow.

To determine whether a loan by a bank or other institutional lender involves the purchase of a security (a promissory note) from the borrower within the purview of federal law and its anti-fraud sections, courts have concocted a whole array of tests. Some attempt to dischotomize the note cases into either commercial or investment transactions, with only the latter being defined as securities. See, e.g., *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973); *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.*, 508 F.2d 1354 (7th Cir.), cert. denied, 423 U.S. 825 (1975). The Second Circuit came up with a short and rather ad hoc list of note transactions which it felt ought not to be covered, and suggested that the test in other transactions should be whether they bear a "strong family resemblance" to those on the list. *Exchange National Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976). The Ninth Circuit held that the ultimate inquiry is whether the lender/investor contributed "risk capital" subject to the borrower's managerial efforts, and enumerated at least six factors to be considered. *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976).

When a business is sold in the form of the sale of 100% of the common stock by a small group of old owners to a small group of new owners, the courts are divided over the applicability of the federal securities laws. The

Seventh Circuit has held that the transaction does not constitute the sale of "securities", *Canfield v. Rapp & Sons, Inc.*, 654 F.2d 459 (7th Cir. 1981), while the Second Circuit has held that it does, *Golden v. Garafalo*, 687 F.2d 1139 (2d Cir. 1982).

Franchising and distributorship agreements have been held to be securities in some cases. See, e.g., *United States v. Herr*, 338 F.2d 607 (7th Cir. 1964); *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), cert. denied, 414 U.S. 821 (1973). They have been held not to be securities in others. See, e.g., *Chapman v. Rudd Paint and Varnish Co.*, 409 F.2d 635 (9th Cir. 1969); *Martin v. T. V. Tempo, Inc.*, 628 F.2d 887 (5th Cir. 1980). The distinction apparently turns on the degree of active participation by the purchaser, and on whether the court perceives the existence of a pyramid sales fraud.

Other areas in which there are decisions of varying tenor involve the sale of some form of personal property accompanied by a servicing or management arrangement, the sale of real estate lots or apartment units, and the sale of memberships in recreational facilities. Decisions by this Court were required to reduce or end conflicts over the status of employee pension plans, *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), bank certificates of deposit, *Marine Bank v. Weaver*, ... U.S. ....., 102 S.Ct. 1220 (1982), and cooperative apartments, *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). The field is surveyed in all its contradictory complexity in C. Schneider, "The Elusive Definition of a 'Security' ", 14 *Rev. Sec. Reg.* 981 (1981).

The results in these cases can be understood and reconciled in some, though not all, instances, but the rationales by which they are justified have become numerous and inconsistent, leaving their extension to new situations in considerable doubt. Lower courts have sometimes endeavored to found their decisions on a mere linguistic parsing of the *Howey* formula, and the whole exercise has taken on an increasingly arbitrary and confusing cast.

3. A clarification by this Court is practicable, and this case is an appropriate vehicle for articulating an approach possessing greater coherence and affording greater guidance.

A return to statutory fundamentals is overdue. The Securities Act of 1933 was intended to improve the functioning of the public capital markets; it adopted two strategies to that end. The registration sections of the Act (§§ 5-8, 10, 11 and 12(1)), which are in issue here, created an elaborate (and expensive) disclosure system for the sale of securities to the public by the firm and its controlling insiders. The anti-fraud sections (§§ 12(2) and 17) established a federal standard, broader than typical state common law misrepresentation and deceit actions, for securities sales generally.

By enacting the registration provisions of the 1933 Act, Congress made the judgment that the value of the information required to be disclosed to the public investing in new securities issued by business firms would typically justify the substantial compliance costs entailed. But as the application of the Act shifts from the public capital market for corporate stocks and bonds to more unusual situations and instruments, the courts are necessarily being asked to decide whether the premises of that judgment remain valid in the marginal cases.

To make such a decision intelligently, a court must be sensitive to the factors that bear on the value of the information generated by the registration statement machinery and on the burden of compliance. More than a mechanical recitation of the *Howey* formula is required for such an analysis. Nor is a simple presumption of broad coverage an adequate substitute; that assumes that disclosure requirements are costless or that Congress made an *un*limited judgment as to their suitability. Neither assumption is true.

In short, in cases outside "the ordinary concept of a security",[2] the definition turns on an assessment of the value of disclosure and the cost burden entailed, in the context of the particular investment involved. The form of the instrument by itself cannot be determinative, as this Court has held.[3]

In making that assessment, modern finance theory can be quite helpful. Capital investments within the purview of the 1933 Act are those made in order to obtain a future (usually monetary) return, as distinguished from consumption investments which are made to obtain and consume a stream of services or satisfactions. This basic distinction was underscored by *United Housing Foundation, Inc. v. Forman, supra,* and *Grenader v. Spitz,* 537 F.2d 612 (2d Cir. 1976).

The expected return from an investment, finance theory holds, is directly proportionate to the expected risk. See,

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[2]H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933); quoted in *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 851 (1975).

[3]*Ibid.*

e.g., W. Sharpe, *Investments* ch. 6 (2d ed. 1981). Risk can be broken down into constituent elements, such as business risk (arising from factors like the variability of demand, production uncertainties, the course of the economy and the performance of management) and financial risk (arising from the debt/equity leverage of the firm). Information and disclosure are of value only as they contribute to a more accurate estimation of the risk and return. Thus the degree of risk of an investment is a necessary ingredient in determining whether it should be subject to the registration disclosure system of the 1933 Act. If an investment is riskless, or of very low risk, the information contained in a registration statement and prospectus might be extensive and detailed, but on average its value would not warrant the costs of furnishing it. That perception is reflected in the exemption sections of the 1933 Act, which exclude from the disclosure machinery investments such as government obligations[4] and commercial paper.[5] It is also reflected in the recent decision of this court that a bank certificate of deposit, because of government regulation and even more importantly because of federal deposit insurance, is not to be considered a security. *Marine Bank v. Weaver, supra;* see also *International Brotherhood of Teamsters v. Daniel, supra.*

Further, when control over the use of the capital assets being invested in is directly transferred to the purchaser, the probable value of registration statement disclosure is at least reduced. The element of management disclosure is eliminated, and the purchaser may be generally presumed to be better informed than the usual investor about

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[4] § 3(a)(2), 15 U.S.C. § 77c(a)(2).

[5] § 3(a)(3), 15 U.S.C. § 77c(a)(3).

the business risks and returns to be expected, so that the added value of the information in a registration statement is probably low. Cf. *Canfield v. Rapp & Sons, Inc.*, 654 F.2d 459 (7th Cir. 1981).

There are a number of other considerations that bear on a determination of the value of registration statement disclosure, but this petition is not the place for an extended discussion. Turning briefly to the cost side, the relevant factors involve such matters as the homogeneity of the business, the size of the investment, the number of purchasers or transactions to be anticipated, and the availability of alternative sources of information. The relative cost of subjecting to 1933 Act registration a single, directly negotiated, small transaction, for example, is quite high. That perception is reflected in the small offering and private placement exemptions of the Act[6] and in this Court's decision on the guarantee agreement aspect of *Marine Bank v. Weaver, supra.*

This has not been an exhaustive delineation of a more coherent approach to the recurrent problem of defining a security. But this sketch is intended to show that such a treatment of the question is both achievable and important.

4. To summarize in conclusion, a "security" for purposes of the Securities Act of 1933 is not a real world object; it is, in the marginal cases, a judgment that the premises of the Act still hold and the value of the required disclosure would warrant its costs. That judgment depends on the interplay of a number of factors, which the *Howey* formula reflects but does not fully express.

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[6] §§ 3(b) and 4(2), 15 U.S.C. §§ 77c(b) and d(2).

Petitioner submits that the decision of the court below conflicts with the decisions of the Fifth Circuit and of this Court, and will lead to inappropriate determinations of the applicability of the federal securities laws. Petitioner also urges that a re-examination and clarification of the security definition, in the light of modern finance theory, is both timely and feasible.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

KENNETH SCOTT
THOMAS M. BOEHM
Attorneys for Petitioner

(Appendices Follow)

Appendix A

United States District Court
Northern District of California

No. C781410 WHO

Dale F. Meyer, on behalf of himself and all others similarly situated,
Plaintiff,

v.

Thomson & McKinnon Auchincloss Kohlmeyer, Inc., a New York corporation, et al.,
Defendants.

[Filed Mar. 20, 1979]

ORDER GRANTING DEFENDANTS' MOTIONS TO DISMISS AND FOR SUMMARY JUDGMENT AND DENYING PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

The motions of defendants to dismiss plaintiff's complaint, pursuant to Rule 12(b)(1) & (6) and for summary judgment, pursuant to Rule 56, and plaintiff's motion for partial summary judgment, came on regularly for hearing on December 8, 1978. The court having received and reviewed the papers filed in support and opposition thereto, and having heard the arguments of counsel, took the matter under submission; by Order filed January 16, 1979, the court ordered a further hearing with respect to specified issues, to be treated as defendants' motions for summary judgment, pursuant to which the parties filed additional memoranda of points and authorities. Thereafter said

motions came on for hearing on March 9, 1979, plaintiffs appearing through Thomas M. Boehm, of Matthews and Marzulla, defendants UCA Systems and Gerald P. Kooyers by Richard S. Burriss of Jones & Burriss, and defendants Thomson McKinnon Securities Inc. and James L. Miller by Bruce W. Belding and Jeffrey Kirchmann of Dinkelspiel & Dinkelspiel; the court having reviewed the memoranda of points and authorities and affidavits filed in support of and in opposition to the motions, and good cause appearing,

IT IS HEREBY ORDERED:

1. That the motions of defendants to dismiss the complaint and for summary judgment be, and they hereby are, granted;

2. That plaintiff's motion for partial summary judgment be, and it hereby is, denied;

3. That the pendent state law claims asserted in the Eleventh and Twelfth Counts be, and they hereby are, dismissed under the doctrine of *United Mine Workers v. Gibbs*;

4. That plaintiff's complaint be, and it hereby is, dismissed;

5. That judgment be entered in favor of defendants and against plaintiff, with costs and disbursements to be taxed by the Clerk.

Dated: Mar 20 1979.

William H. Orrick

Judge, United States District Court

Appendix B

United States Court of Appeals
for the Ninth Circuit

No. 79-4323
DC #C78-1410 WHO
Northern California

Dale F. Meyer, on behalf of himself
and all others similarly situated,
Plaintiff/Appellant,

vs.

Thomas & McKinnon Auchincloss
Kohlmeyer, Inc., et al.,
Defendants/Appellees.

[Filed September 9, 1982]

OPINION

Appeal from the United States District Court
for the Northern District of California
Honorable William H. Orrick, District Judge, Presiding

Argued and submitted October 14, 1980
Submission withdrawn March 25, 1981.
Resubmitted June 2, 1982

Before: SKOPIL and POOLE, Circuit Judges, and HALBERT, Senior District Judge.*

POOLE, Circuit Judge.

Meyer appeals a summary judgment and dismissal of his complaint against UCA Systems, Inc. (UCA), a commodi-

*The Honorable Sherrill Halbert, Senior United States District Judge for the Eastern District of California, sitting by designation.

ties advisor, Thomson McKinnon Securities, Inc. (Thomson), a securities and commodities brokerage firm formerly known as Thomson & McKinnon Auchincloss Kohlmeyer, Inc., and two individuals associated with those companies.

Thomson sold Meyer a discretionary commodities trading account that was to be managed by UCA. When the account proved unsuccessful, Meyer withdrew his funds. He later brought a complaint, asserted as a class action, alleging that the accounts sold by Thomas [sic] and UCA to himself and other members of his putative class were securities under 15 U.S.C. § 77(b), that these securities were not registered as required by 15 U.S.C. § 77(e), and that Meyer and other members of the putative class were therefore entitled to rescission under 15 U.S.C. § 77(1). Various other claims were raised whose validity depended upon a determination that the commodities accounts were "securities" under the federal securities law. The district court held that they were not. We affirm.

Jurisdiction

Appellees claim that the matter was not properly before the district court because jurisdiction over this action rests exclusively in the Commodities Exchange Commission. We have today decided that the district court retains jurisdiction over private actions arising out of commodities transactions. *Mordaunt v. Incomco*, ... F.2d ....., No. 78-3499 (9th Cir. 1982). *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, ... U.S. ....., 102 S.Ct. 1825 (1982).

"Securities"

The sole question presented for review here is whether the discretionary commodities account sold to Meyer was an "investment contract" and therefore a "security" within

the meaning of 15 U.S.C. § 77(b). In order to constitute an investment contract, the account must be a "common enterprise." *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). This question is controlled by the holdings in *Mordaunt* and *Brodt v. Bache & Co.*, 595 F.2d 459 (9th Cir. 1978). In each case, this court has determined that discretionary commodities trading accounts were not common enterprises on facts indistinguishable from those presented here.

Meyer attempts to distinguish *Brodt* by drawing attention to the fee structure employed by UCA with respect to his account. UCA exacted a quarterly commission based upon a percentage of the assets managed in a given quarter, payable in advance and not refundable in the event that the investor closed his account before the quarter's end.

Meyer argues that by this arrangement UCA shared in his profits and losses and was therefore engaged in a common enterprise with him. We disagree. Plainly, just as in *Mordaunt* and *Brodt*, the promoter continued to profit through commissions even as the account lost money. On the other hand, had the account been successful, the promoter would not necessarily have shared the benefits because Meyer could elect to withdraw profits as they accrued. Judged in light of economic realities, this account was no different from those at issue in *Mordaunt* and *Brodt* and therefore does not qualify as a security within the meaning of 15 U.S.C. § 77(b).

The judgment of the district court is AFFIRMED.

Appendix C

United States Court of Appeals for the Ninth Circuit
William L. Whittaker, Clerk U.S. District Court
Northern District of California

No. 79-4323
DC CV 78-1410 WHO

Dale F. Meyer, on behalf of himself and all others similarly situated,
Plaintiff/Appellant,

vs.

Thomas & McKinnon Auchincloss, Kohlmeyer, Inc., et al.,
Defendants/Appellees.

[Filed Oct 7 1982]

Appeal from the United States District Court for the Northern District of California.

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California and was duly submitted.

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered September 09, 1982

A True Copy
Attest Oct 1 - 1982
Phillip B. Winberry
Clerk of Court
by:
Deputy Clerk

Exhibit "B"

Appendix D

Supreme Court of the United States
No. A-442

Dale F. Meyer, Etc.,
Petitioner,

v.

Thompson McKinnon Securities, Inc., et al.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

Upon Consideration of the application of counsel for petitioner.

It Is Ordered that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including January 14, 1983.

/s/ William H. Rehnquist
Associate Justice of the Supreme Court of the United States

Dated this 17th day of November, 1982

Appendix E

Section 2, Securities Act of 1933, 15 U.S.C. § 77b(1):

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, pre-organization certificate or subscription, transferrable share, *investment contract*, voting trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any the foregoing. (Emphasis added.)

Section 5, Securities Act of 1933, 15 U.S.C. § 77e(c):

> It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security . . .

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No. 82-1195

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

DALE F. MEYER,
on behalf of himself and
all others similarly situated,
Petitioner,

vs.

THOMSON & MCKINNON AUCHINCLOSS KOHLMEYER, INC.,
UCA SYSTEMS, INC., JAMES L. MILLER,
and GERALD P. KOOYERS

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION

Respondents Thomson McKinnon Securities Inc. (hereinafter "Thomson McKinnon") and James L. Miller (hereinafter "Miller") hereby oppose the petition of Dale F. Meyer (plaintiff below, hereinafter "Petitioner") for a writ of certiorari.

STATEMENT OF CASE

This case arises from the trial court's granting of all of Respondents' motions for summary judgment and motions to dismiss the complaint,[1] affirmed by the United States

[1]Order Granting Defendants' Motions to Dismiss and for Summary Judgment, filed March 20, 1979, Appendix "A" to Petition for a Writ of Certiorari [hereinafter "Petition for Writ"], received by Respondents January 17, 1983.

Court of Appeals for the Ninth Circuit.[2] While these rulings were predicated on a finding that "there is no genuine issue as to any material fact . . ."[3], the case was not decided on the purported "undisputed facts"[4] alleged by Petitioner.[5]

Petitioner is a very experienced, compulsive and impetuous commodities speculator. Prior to any trading in commodities through Respondents, Petitioner had maintained commodities trading accounts with at least six different brokerage firms (R. 46, p 2; R. 59)[6] and had subscribed to at least a dozen different commodity research and advisory services or newsletters, as well as a number of different commodities magazines and informational publications (R. 46, pp. 2-3). From early 1973 through mid-1977 Petitioner actively traded commodities through his own commodities trading accounts (incurring significant losses), participated in a commodity investment partnership managed by an independent advisor with whom Petitioner was familiar,[7] then joined another commodities trading partnership through a different brokerage firm and withdrew his profits in June, 1977 (R. 46, p. 4). In April, 1977 Petitioner telephoned Miller, then employed as an

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[2]*Meyer v. Thomson & McKinnon*, 686 F.2d 818 (9th Cir. 1982).

[3]Rule 56(c), Federal Rules of Civil Procedure.

[4]Petition for Writ at 2.

[5]This Statement of Case is submitted to more completely and accurately describe the facts, as permitted when it is "deemed necessary in correcting any inaccuracy or omission in the statement by the other side . . . ." Rule 34(2), U.S. Supreme Court Rules.

[6]"R" refers to the Clerk's Record in the Court of Appeals.

[7]After disagreeing with the first or second trade effected by the advisor, Petitioner immediately cancelled and withdrew his funds (R. 56, pp. 2-4).

account executive with Thomson McKinnon, "to find out what other advisors or managers were active that [Petitioner] might consider," and specifically inquired about Respondent UCA Systems, Inc. (hereinafter "UCA"); Petitioner called a representative of UCA on his own on several occasions (R. 46, p. 4; R. 56. pp. 2-3).

On August 12, 1977, Petitioner engaged the advisory services of UCA (R. 56, p. 3) by entering into a Commodity Advisor's Investment Advisory Agreement ("Advisory Agreement") for the purpose of trading in commodities future contracts (R. 8, Ex. A) and opened a commodities account with Thomson McKinnon from which Petitioner authorized the payment of management fees to UCA (R. 59, Petitioner's deposition [hereinafter "Depo."], Vol. II, pp. 73-74). He also executed a Limited Power of Attorney authorizing UCA to order trades in his commodity account (*Id.*, Vol. II, p. 74). Under the Advisory Agreement, Petitioner granted UCA exclusive authority to direct Thomson McKinnon to execute commodities transactions for Petitioner's account and risk (R. 8, Ex. A) and agreed that all commissions and expenses would be charged to his account (*Id.*, ¶ 5), but Petitioner retained the right at his sole discretion to withdraw funds from his commodities account at any time (*Id.*, ¶ 1); the Advisory Agreement was terminable at will by either Petitioner or UCA (*Id.*, ¶ 4). The Advisory Agreement provided that Petitioner would pay UCA a quarterly fee of six percent of the value of the assets being managed by UCA at the beginning of the quarter (*Id.*, ¶ 8); it contained no provision for increasing or decreasing the fee in the event of profits or losses in Petitioner's account, and the fee was not to be refunded or

prorated in the event of termination of the agreement before the end of the quarter (*Id.*, ¶ 4). Thomson McKinnon was to be paid commissions on a per trade basis, irrespective of profits or losses or the value of the account.

Less than three months later, in November, 1977, Petitioner terminated his Advisory Agreement with UCA because he had not realized a net profit in his account every month (R. 59, Depo. Vol. II, pp. 102-103). After terminating UCA's advisory services, Petitioner advised Thomson McKinnon that he wished to continue trading commodities through Thomson McKinnon on his own (without an independent advisor), but after investigation Thomson McKinnon advised Petitioner that it would not permit him to continue speculating in commodities through Thomson McKinnon (R. 46, p 5; R. 47, p 2; R. 56, p. 4). Thereafter, Petitioner reopened a commodities account at E.F. Hutton & Company, where he traded in commodities futures contracts for approximately three months (R. 59, Depo. Vol. II, p. 58). Then, one month after commencing this litigation, Petitioner opened a commodity account with Clayton Brokerage Company (R. 59, Depo. Vol. II, pp. 4-5). And on December 4, 1978, barely a few days prior to the first hearing on Respondents' motions to dismiss, Petitioner opened yet another commodity trading account—with the Denver office of Thomson McKinnon! (R. 58)[a]

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[a]This Statement of Case more accurately describes Petitioner's continuous speculation in commodities, during which he repeatedly changed brokerage firms, his manner of speculating, and his own inquiries (rather than being "persuaded" [Petition for Writ, p. 2] by Respondents) as to investment advisors, and directly dispels Petitioner's characterization that Respondents "sold" investments in discretionary accounts (*Id.*).

CERTIORARI SHOULD BE DENIED

1. Summary of Argument

The unique and narrow facts of this case do not warrant the exercise of this Court's extraordinary and discretionary jurisdiction. This is not a case of far-reaching significance but, rather, is confined to the claims of one compulsive and impetuous commodities speculator in search of a broker or advisor through whom to further his speculative desires. In no sense does this case involve an "investment" in the classic sense, or a "purchase" of stock, partnership interests, or traditional securities. Petitioner's suit, purposely omitting claims under the Commodity Exchange Act, has been correctly and fairly reviewed and rejected by an able district court judge and a thorough panel of judges from the Ninth Circuit Court of Appeals; any further review is unwarranted.

There is no need for this Court, in the context of the facts of this case, to consider additional regulation of discretionary commodities accounts. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, ... U.S. ....., 102 S.Ct. 1825 (1982), this Court held that there was an implied private right of action under the Commodity Exchange Act for fraud in favor of a commodity speculator against his broker.[9] Further, and significantly, the regulatory controls of the amended Commodity Exchange Act[10] and the rules and regulations promulgated pursuant to the authority granted to the Commodity Futures Trading Commission

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[9]102 S.Ct. at 1834. In affirming dismissal of the federal securities law claims, the Court did not disturb the Sixth Circuit's holding that a discretionary commodities account was not a security. *Id.* at 1834 n. 40.

[10]7 U.S.C. §§ 1-24 (1976 & Supp. III 1979).

("CFTC") provide a comprehensive system of protection to commodities traders; the CFTC has been granted exclusive jurisdiction in the field of commodities regulation, including discretionary commodities accounts. The existence of a comprehensive scheme of protective legislation militates against the implication of rights under the securities laws.[11] Finally, this case involves a narrow and unique, if perhaps academically interesting area, upon which valuable court time should not be spent.

2. The decision below was correct, fair and consistent

The Ninth Circuit, in applying the three-prong test of *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), i.e., that to find an investment contract there must be (1) an investment of money, (2) in a common enterprise, (3) with profits to come solely from the efforts of others, 328 U.S. at 301, and relying on *Brodt v. Bache & Co.*, 595 F.2d 459 (9th Cir. 1978) and *Mordaunt v. Incomco*, 686 F.2d 815 (9th Cir. 1982), determined that in this case there was no common enterprise, hence no investment contract or "security", and, judging the arrangement "in light of economic realities", affirmed. 686 F.2d at 819.

The focus of the federal securities laws is, and should be, "on the capital market of the enterprise system: the sale of securities to raise capital for profit making purposes . . . ." *United Housing Foundation, Inc. v. Forman,*

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[11] *See International Brotherhood of Teamsters, etc. v. Daniel*, 439 U.S. 551 (1979) (employee's interest in a pension plan not a security, in view of the comprehensive legislation of ERISA); *Marine Bank v. Weaver*, ... U.S. ..., 102 S.Ct. 1220, (1982) (certificate of deposit not a security, since issuing bank was subject to comprehensive regulations covering the banking industry).

421 U.S. 837, 849 (1975). In *Forman*, the Court, applying the *Howey* test, held that shares in a housing cooperative did not constitute securities and commented that the shares lacked the characteristics "that in our commercial world fall within the ordinary concept of a security." 421 U.S. at 851. Applying a similar rationale to this case, Petitioner's speculation in commodities and utilization of various brokerage firms and investment advisors to help effect his speculation, can hardly be characterized as traditional investments or purchases of securities.

In *Howey*, the Respondents sold investors small tracts of land in a large citrus grove development and offered service contracts whereby respondents would cultivate, harvest and market the citrus and remit proportionate shares of the net proceeds to the investors. The Court stated:

> "[These are] something more than fee simple interest in land. . . . They are offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. . . .
>
> Thus all the elements of a profit-seeking business venture are present here. The investors provide capital and share in the earnings and profits . . . ."

328 U.S. at 299-300.

As distinguished from the facts in *Howey*, here, Petitioner's trading in commodities futures contracts depended on no larger enterprise; none of the Respondents joined Petitioner's speculation in commodities futures contracts, nor did they seek the use of Petitioner's money to finance any enterprise in which they were engaged with Petitioner.

There was no "financial" commonality between Petitioner and Respondents; Respondents' only "investments" were their time and skills. Petitioner did not contribute capital to share in the profits of Thomson McKinnon's brokerage business or UCA's advisory business. He did not buy shares of either of the Respondents, but, rather, he was speculating in commodities.

Petitioner alleges that a conflict exists between the decision below and *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974). It should be noted that *Continental Commodities* was decided before the extensive 1974 amendments to the Commodity Exchange Act[12] which transferred authority over commodity futures regulation from the Department of Agriculture to the CFTC. 7 U.S.C. § 4a(a)(1). Also, the analysis in *Continental Commodities* has been discredited, and in large part has not been followed, in significant subsequent cases. For example, in *Curran v. Merrill Lynch*, 622 F.2d 216 (6th Cir. 1980), *aff'd*, 102 S.Ct. 1825 (1982), the Sixth Circuit rejected *Continental Commodities* and followed *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972), *cert. denied*, 409 U.S. 887 (1972), and quoted *Brodt v. Bache & Co.*, *supra*, 595 F.2d 459 (9th Cir. 1978), with approval. 622 F.2d at 222, 223 n. 7. In so doing, the Sixth Circuit held that a discretionary commodity account was not a security subject to the federal securities laws. *Id.* at 224. This holding was expressly noted, and was not disturbed, by this Court in its landmark decision holding that a private right of action is available to private parties under the Commodity

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[12]Pub.L. No. 93-463, 88 Stat. 1389 (1974) (effective April 21, 1975).

Exchange Act. *Merrill Lynch v. Curran, supra*, 102 S.Ct. at 1834 n. 40.

Based on the above, Respondents respectfully submit that there is no significant conflict warranting the grant of certiorari by this Court. However, alternatively, should this court determine that review is appropriate in light of the alleged conflict with *Continental Commodities*, we respectfully urge that the protection of the securities laws should not be extended to this discretionary commodities account, since there already exists a comprehensive scheme of legislation covering commodities and discretionary commodities accounts,[13] and since exclusive jurisdiction over discretionary commodity accounts has been vested by Congress in the CFTC.[14]

3. There is no need for this court to grant certiorari and determine that a security is involved as protective legislation already exists

The Commodity Exchange Act, as amended by the Commodities Futures Trading Commission Act of 1974, provides that:

> The [Commodity Futures Trading] Commission shall have exclusive jurisdiction with respect to accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery traded or executed on a contract market. . . ."

7 U.S.C. § 2.

That Congress intended to invest the CFTC with exclusive jurisdiction over commodities trading accounts by

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[13] *See supra* footnote 10, and discussion *infra* pp. 8-10.

[14] 7 U.S.C. § 2, 4(a). *See* Note, *Federal Regulation of Discretionary Commodity Accounts*, 32 Hastings L.J. 871, 891 (1981) [hereinafter cited as *Note*].

this amendment is reflected in the Conference Report as follows:

> The *Senate* amendment retains the provisions of the *House* bill but adds three clarifying amendments. The clarifying amendments make clear that (a) the Commission's jurisdiction over futures contract markets or other exchanges is exclusive *and includes the regulation of commodity accounts, commodity trading agreements, and commodity options.*

H. R. Rep. No. 1383, 93rd Cong., 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Ad. News 5843, 5897 (emphasis added).

This Court has recognized the sweeping changes implemented by the 1974 amendments to the Commodity Exchange Act, and that those new procedures constitute a comprehensive legislative scheme for investor protection etc. *Merrill Lynch v. Curran,* ..... U.S. ....., 102 S.Ct. 1825 (1982). We urge that "[t]he scope of the regulation affording protection to the investor in a discretionary commodity account under the Commodity Exchange Act obviates any reason to require these accounts to be registered under the Securities Act of 1933."[15]

This court has recently refused to expand the protection of the federal securities laws to an employee's interest in a pension fund in *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551 (1979) and to a certificate of deposit issued by a bank *Marine Bank v. Weaver,* ..... U.S. ....., 102 S.Ct. 1220 (1982). In both instances, the Court refused to expand the definition of "security" to encompass the interests there involved, on the grounds, at least

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[15]*See Note, supra* note 14, at 884.

in part, that comprehensive legislation existed elsewhere providing the requisite regulation and protection.

In *Daniel*, the Court stated:

> If any further evidence were needed to demonstrate that pension plans of the type involved are not subject to the Securities Acts, the enactment of ERISA in 1974 would put the matter to rest. Unlike the Securities Act, ERISA deals expressly and in detail with pension plans. . . . in contrast to the indefinite and uncertain disclosure obligations imposed by the antifraud provisions of the Securities Act. . . .
>
> The existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. Congress believed that it was filling a regulatory void when it enacted ERISA. . . . Not only is the extension of the Securities Acts by the court below unsupported by the language and history of those Acts, but in light of ERISA it serves no general purpose. . . . Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more detailed form through ERISA.

439 U.S. at 569-70.

The comprehensive legislation regulating commodities trading and the commodity futures markets under the amended Commodity Exchange Act, similarly, "severely undercuts all arguments for extending the Securities Acts" to discretionary commodity accounts.

Likewise, in *Marine Bank*, this Court held that a certificate of deposit issued by a federally regulated bank was not a security, since the issuing bank "is subject to the

comprehensive set of regulations governing the banking industry." 102 S.Ct. at 1224.[16]

4. This case is unique, confined to its facts, and does not warrant the extraordinary invocation of this Court's discretionary review

While Petitioner purports to state a far-reaching issue,[17] it is clear from our Statement of Case that there was no "investment" here. Instead, Petitioner continued his own commodities speculation, using the "proprietary computer selection formula" unique to UCA and to this case.[18] In fact, it was from the *performance* resulting from the use of this system that Petitioner decided to terminate using UCA's advisory services.

The need to "clarify" the definition of security in this context may be an interesting academic exercise. However, this Court has refused to hear petitions where the issue in question is merely one of academic interest. *Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 74 (1955).

As indicated above, a legally correct and fair decision was rendered below, on the limited dispute between the parties involving the specific Advisory Agreement involved in this case, and we respectfully urge that no amount of

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[16]In *Marine Bank* the court referred directly to its prior decision in *Daniel* and quoted the language quoted above. 102 S.Ct. 1224 n.7.

[17]"Whether investment in a managed commodity futures trading program based on a proprietary computer selection formula and marketed to the general public through a brokerage firm may involve the sale of an investment contract, and therefore of a security. . . ." Petition for Writ, p.i.

[18]"The Statistical Qualifier System is a unique approach. . . . [A] statistical discriminator is used. . . ." Petition for Writ, p. 3.

strained argument should magnify this case into one warranting consideration by this Court.

CONCLUSION

Respondents Thomson McKinnon and Miller respectfully urge that the petition for certiorari be denied.

Respectfully submitted,

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RESPONDENTS' UCA SYSTEMS, INC. AND GERALD P. KOOYERS BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Petitioner's discretionary commodities futures account, managed by a commodity trading advisor licensed under and subject to the disclosure, record keeping and other regulatory provisions of the Commodity Exchange Act, as amended by the Commodity Futures Trading Commission Act of 1974, is a security required to be registered under the Securities Act of 1933.

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Respondents.

**On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit**

RESPONDENTS' UCA SYSTEMS, INC. AND GERALD P. KOOYERS BRIEF IN OPPOSITION

Respondents, UCA Systems, Inc. and Gerald P. Kooyers, adopt, for the purposes of this Memorandum, the material in Petitioner's Petition under the headings, "Opinions Below" and "Jurisdiction."

STATUTES INVOLVED

The relevant provisions of section 2(a)(1) of the Commodity Exchange Act, as amended by the Commodity Futures Trading Act of 1974, 7 U.S.C. § 2, and sections 2 and 5 of the Securities Act of 1933, 15 U.S.C. §§ 77b(1) and 77e(c), are set forth in the Appendix (App. A).

STATEMENT OF THE CASE

This case was decided on undisputed facts:

Respondent Gerald P. Kooyers, ["Kooyers"], was the president and sole shareholder of Respondent UCA Systems, Inc. ["UCA"] a California corporation. (Second Augmented Excerpt of Record, Affidavit of Gerald P. Kooyers in Support of Motion to Dismiss Complaint or in the Alternative to Grant Summary Judgment, 22:21-22). UCA, through Kooyers, was licensed as a commodity trading advisor with the Commodity Futures Trading Commission, pursuant to the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.* (*Id.* 22:22-26)

On August 12, 1977, Petitioner Dale Meyer entered into a Commodity Advisor Investment Advisory Agreement, ["Advisory Agreement"] for the principal purpose of investing in commodity futures contracts (CR 8, First Amended Complaint, Exhibit A),[1] opened a commodity account with Thomson McKinnon Securities, Inc., ["Thomson"], (CR 59, Deposition of Dale F. Meyer, taken October 24, 1978, 73:18-74:8), deposited $40,000.00 into his commodity account at Thomson (CR 8, Exhibit A), and executed a limited power of attorney authorizing UCA to order

[1] "CR" refers to the original record filed in the court of appeals.

trades in his commodity account (CR 59, Deposition of Dale F. Meyer, taken October 24, 1978, 74:9-24).

Although Petitioner's Advisory Agreement (the terms of which are set forth in Appendix B) expressly granted UCA exclusive authority to direct Thomson to execute transactions, (App. B), Petitioner initially directed UCA as to which portfolio of commodities to invest in, and retained the right to modify the Commodity Trading Portfolio at his sole discretion. *(Id.* paragraph 2). Petitioner had the right, in his sole discretion, to withdraw funds from his commodity account at any time (*Id.*, paragraph 1). The Advisory Agreement was terminable at will by either Petitioner or UCA (*Id.*, paragraph 4). In compensation for the services rendered to him by UCA, Petitioner agreed to pay UCA, in advance, a quarterly fee equal to six (6%) percent of the value of his assets being managed by UCA at the beginning of each quarter *(Id.*, paragraph 8). There was no contractual provision for increasing or decreasing the fee as a function of profits or losses incurred in Petitioner's account, and the Advisory Agreement did not provide for a refund or proration in the event of termination before the end of any quarter (*Id.*, paragraph 4). The Advisory Agreement expressly provided for all commissions or expenses arising from transactions or functions exercised in administration of the account to be charged to Petitioner's account (*Id.*, paragraph 5).

In November 1977, Petitioner terminated his Advisory Agreement with UCA because he had not realized a net profit in his account every month (CR 59, Deposition of Dale F. Meyer, taken October 24, 1978, 102:26-103:13). Petitioner's account had a net trading loss of Six Thousand Two Hundred Ninety-Eight Dollars and Fifty Cents ($6,298.50) including brokerage commissions and management fees. (CR 24, Exhibit A to UCA's Answers and Objections to Plaintiff's First Set of Interrogatories).

ARGUMENT

The decision below, holding that the Petitioner's discretionary commodities futures trading account is not a "security" within the meaning of 15 U.S.C. § 77b(1), nor required to be registered under section 5 of the Securities Act of 1933, 15 U.S.C. § 77e(c), is plainly correct.

1. The Exclusive Jurisdiction Provision of the Commodity Exchange Act, as Amended by the Commodity Futures Trading Commission Act of 1974, Precludes Application of the Federal Securities Laws

The exclusive jurisdiction provision, section 2(a)(1) of the Commodity Exchange Act, 7 U.S.C. § 2, as amended by the Commodity Futures Trading Commission Act of 1974, P.L. 93-436, 88 Stat. 1389, precludes the registration of discretionary commodities futures trading accounts under section 5 of the Securities Act of 1933, 15 U.S.C. § 77e(c). Section 2(a)(1) granted the Commodity Futures Trading Commission ["CFTC"] ". . . exclusive jurisdiction with respect to accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery . . . ." 7 U.S.C. § 2. Since only commodity futures are purchased by the Petitioner's discretionary futures commodities trading account, it is certainly within the preemptive language.

The legislative history of the Commodity Future Trading Commission Act of 1974 clearly supports the exclusive jurisdiction of the CFTC over discretionary commodities accounts. As this Court noted in *Curran v. Merrill Lynch, Pierce, Fenner & Smith,* ..... U.S. ..... 102 S.Ct. 1825, 1843 (1982): "The purpose of the exclusive jurisdiction provision in the bill passed by the House was to separate functions of the Commission [CFTC] from those of the Securities Exchange Commission and other regulatory

agencies." (Bracketed material added, footnotes omitted). The provision in the bill passed by the House provided as follows:

> Provided, that the Commission shall have exclusive jurisdiction of transactions dealing in, resulting in, or relating to contracts of sale of a commodity for future delivery . . .: *And provided further,* That nothing herein contained shall supersede or limit the jurisdiction at any time conferred on the Securities Exchange Commission or other regulatory authorities under the laws of the United States . . ." H.R. 13113, 93d Cong., 2d Sess., 201 (1974), *cited in Curran, supra,* 102 S.Ct. at 1843, n.81.

While the House version may have allowed limited joint jurisdiction by the Securities Exchange Commission ["SEC"] and the CFTC over some aspects of commodity futures trading, the Senate amended the House provision "in an attempt to avoid unnecessary overlapping and duplicative regulation." Staff of Senate Comm. on Agriculture and Forestry, 93d Cong., 2d Sess., The Commodity Futures Trading Commission Act of 1974, at 6 (Comm. Print 1974), *quoted in SEC v. American Commodity Exch., Inc.,* 546 F.2d 1361, 1368 (10th Cir. 1976).

The Conference accepted the Senate amendment. The legislative history reveals the scope of the CFTC's exclusive jurisdiction intended by Congress:

> The *Senate* amendment retains the provision of the *House* bill but adds three clarifying amendments. The clarifying amendments make clear that (a) the Commission's jurisdiction over futures contract markets or other exchanges is exclusive and includes the regulation of commodity accounts, commodity trading agreements, and commodity options; (b) the Commission's jurisdiction, where applicable, supersedes State as

well as Federal agencies; and (c) Federal and State courts retain their respective jurisdictions.

. . . .

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned. H.R. Rep. No. 1383, 93d Cong., 2d Sess. 35, *reprinted in* [1974] U.S. Code Cong. & Ad News 5894, 5897.

The legislative history of the Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865, which amended the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.*, further confirmed the exclusive nature of the CFTC's jurisdiction, stating that the CFTC was designed "to avoid duplication and confusion in the regulation of futures trading." S. Rep. No. 850, 95th Cong., 2d Sess. 21, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2109.

The exclusive jurisdiction of the CFTC has been upheld repeatedly against attempts at regulation by other federal administrative and legislative authorities. *See Gonzalez v. Paine, Webber, Jackson & Curtis, Inc.*, COMM.FUT.L.REP. ¶ 21,615 (S.D.N.Y. Nov. 4, 1982); *Berman v. Bache, Halsey, Stuart, Shields, Inc.*, 467 F. Supp. 317, 319 (S.D. Ohio 1979); *R.J. Hereley & Son Co. v. Stotler & Co.*, 466 F.Supp. 213 (D. Kan. 1979); *Hofmayer v. Dean Witter & Co.* 459 F.Supp. 733 (N.D. Cal. 1978); *Bartels v. International Commodities Corp.*, 435 F.Supp. 865 (D. Conn. 1977).

As the Court in *E.F. Hutton & Co. v. Schank*, 456 F.Supp. 507 (D.Utah, 1976) stated at page 513:

> . . . there is little reason to attempt to construe *Howey* so as to include discretionary commodities accounts within the bailiwick of the securities act and the SEC. Indeed, because of the exclusive jurisdiction which Congress granted the CFTC over "accounts,

agreements, and transactions involving contracts of sale of a commodity for future delivery," it would fly in the face of express congressional intent to do so.

The CFTC's Office of General Counsel has also stated that Section 2(a)(1) of the Commodity Exchange Act vests the CFTC with "exclusive jurisdiction with respect to accounts, agreements, and transactions involving commodity futures contracts, both discretionary and non-discretionary, and that the exclusivity of its jurisdiction is not affected by whether the account agreement or transaction might otherwise be viewed as a 'security'." CFTC Interpretative Letter No. 77-2 [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,257, at 21,371 (Jan. 14, 1977).

2. The Commodity Exchange Act Provides Adequate Protection

The express Congressional intent to grant the CFTC exclusive jurisdiction, 7 U.S.C. § 2, and the comprehensive legislation regulating the commodity futures trading markets under the Commodity Exchange Act, 7 U.S.C. §§ 1-24, as amended by the Commodity Futures Trading Commission Act of 1974, P.L. 93-436, 88 Stat. 1389, (hereinafter collectively referred to as "CEA"), "severely undercuts all arguments for extending the Securities Acts", *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551, 569, (1979), (discussed at greater length, commencing at p. 9 of this brief) to discretionary commodities futures trading accounts. The scope of the regulation affording protection to the investor in a discretionary commodities futures trading account under the CEA obviates any reason to require these accounts to be registered under the Securities Act of 1933. As this Court noted in *Curran,* ..... U.S. ....., 102 S.Ct. 1825 (1982): "The Commodity Exchange Act (CEA), 7 U.S.C. § 1 *et seq.* (1976 ed. and Supp. III), has been aptly characterized as 'a comprehensive reg-

ulatory structure to oversee the volatile and esoteric futures trading complex'." 102 S.Ct. at 1827, (footnote omitted), *quoting* H.R. Rep. No. 93-975, 93d Cong. 2dSess. 1 (1974) U.S.Code Cong. & Admin. News 1974, p. 5843.

Petitioner's discretionary commodities futures trading account was to be managed by a registered commodity trading advisor, UCA. UCA was both regulated and registered by the CFTC. See Sections 2(a)(1), 4b, 4c, 4l, 4m, 4n, 4o, 8a, and 19 of the CEA, 7 U.S.C. §§ 2 *et seq.* The CFTC is vested with rule making authority to govern its operating procedures, 7 U.S.C. § 4a(j)(1976), and has enacted rules specifically designed to protect those who invest through discretionary commodities accounts. In many respects, the commodities provisions are patterned after the securities laws. Since the enactment of the Commodity Futures Trading Commission Act of 1974, the CFTC has continually expanded the disclosure rules governing discretionary commodities future accounts, which are currently embodied in 46 F.R. 26004 (1981). The CEA also contains several antifraud provisions. The main antifraud provision is section 4b of the CEA, 7 U.S.C. § 6b (1976). As this Court noted in *Curran*, ... U.S. ....., 102 S.Ct. 1825 (1982): "The language of § 4b is similar to that of § 10(b) of the Securities Act of 1934, 15 U.S.C. § 78i(b) . . ." 102 S.Ct. at 1845. Section 4o(1) covers fraud with respect to commodity trading advisors and commodity pool operators. 7 U.S.C. § 6o(1) (1976).

The adequacy of the CEA enforcement provisions precludes the need for commodity investors' private actions under the federal Securities Acts. The CFTC's enforcement powers include the authority to withdraw or suspend a board of trade's designation as a contract market, 7 U.S.C. §§ 7b, 8(a) (1976), and deny violators access to the markets, *Id.* §§ 9, 12c. In addition, the CFTC may seek injunctions or restraining orders in the courts, *Id.* § 13a-1,

assess fines up to $100,000, *Id.* § 13a, disapprove contract market bylaws, rules and regulations, *Id.* § 7a(12), and refer criminal violations of the CEA to the Department of Justice, *Id.* § 13a. Moreover, the Department of Justice can seek imposition of criminal penalties up to $100,000. *Id.* at 13(a)-(c), 13b.

In addition to CFTC enforcement, private parties have an administrative remedy known as a reparation proceeding. 7 U.S.C. § 18 (1976). Under section 14(a) of the amended CEA aggrieved commodity investors may bring complaints of alleged violations of the Act or of CFTC regulations before an administrative law judge. *Id.* § 18(a). Under the reparations mechanism, the CFTC has the authority to award money damages. *Id.* § 18.

Additionally, section 5a(11) of the CEA provides investor recourse to arbitration. 7 U.S.C. § 7a(11) (1976). Under said section commodity exchanges are required to "provide a fair and equitable procedure through arbitration or otherwise . . . for the settlement of customers' claims and grievances against any member or employee [of the exchange]" (bracketed material added). The procedure applies only to claims involving less than $15,000, and is designed to encourage the speedy resolution of smaller customer disputes at the exchange level. (Petitioner's loss totaled $6,298.50. *Supra*, p. 2 of this brief). The 1974 amendments also included a new section 14 that expressly authorizes actions for money damages. See 88 Stat. 1393-1394. This adjudicatory procedure apparently is designed to resolve larger disputes or smaller section 5a(11) disputes that are not settled. The actions are brought before the CFTC rather than before an exchange. There is no limit on the amount of damages that may be awarded. The Commission's judgments are enforceable by actions in federal district court. 7 U.S.C. § 18 (1976).

This Court's recent decision in *Curran*, ... U.S. ....., 102 S.Ct. 1825 (1982), holding that Congress intended the federal courts to recognize implied causes of action under five separate provisions of the CEA provides still another means for investor recourse. (The five sections are §§ 4a, 7 U.S.C. § 6a; 4b, 7 U.S.C. § 6b; 5(d), 7 U.S.C. § 7(d); and 9(b), 7 U.S.C. § 13(b).) Thus, the remedies and enforcement provisions available under the CEA made the application of the federal Securities Acts to commodity transactions unnecessary and inappropriate.

This Court's recent decisions in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979) and *Marine Bank v. Weaver*, ... U.S. ....., 102 S.Ct. 1220 (1982), by analogy, may be interpreted as limiting the jurisdiction of the federal Securities Acts in the area of discretionary commodity accounts.

In *Daniel, supra*, this Court held that a noncontributory, compulsory pension plan was not a security. One of the reasons for the holding in *Daniel* was that the pension plan was regulated by the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1381 (1976): "The existence of this comprehensive legislation governing the use and terms of employee plans severely undercuts all arguments for extending the Securities Act to noncontributory, compulsory pension plans." *Daniel, supra*, 439 U.S., at 569-570, *quoted in Marine Bank, supra*, 102 S.Ct. at 1224, n.7. "Since ERISA regulates the substantive terms of pension plans, and also requires certain disclosures, it was unnecessary to subject pension plans to the requirements of the federal securities laws as well." *Marine Bank, supra*, 102 S.Ct. at 1224 n.7, explaining *Daniel, supra*.

Similarly, in *Marine Bank, supra*, this Court held that a certificate of deposit issued by a federally regulated bank was not a security, "since the holders of bank certificates

of deposit are abundantly protected under the federal banking laws." *Id.* 102 S.Ct. at 1225. As this Court explained:

> "This certificate of deposit was issued by a federally regulated bank which is subject to the comprehensive set of regulations governing the banking industry. Deposits in federally regulated banks are protected by the reserve, reporting, and inspection requirements of the federal banking laws; advertising relating to the interest paid on deposits is also regulated. In addition, deposits are insured by the Federal Deposit Insurance Corporation." *Id.* 102 S.Ct. at 1224. (footnotes omitted)

The analogy to Petitioner's discretionary commodities futures trading account is compelling. The comprehensive legislation regulating the commodity futures markets under the CEA, 7 U.S.C. §§ 1-24, similarly "severely undercuts all arguments for extending the Securities Acts", *Daniel, supra,* 439 U.S. at 569, to discretionary commodity accounts.

This Court's decisions in *Daniel, supra,* and *Marine Bank, supra,* specifically reject the propriety of extending the operation of the Securities Acts to an area in which Congress has established an independent regulatory scheme. Congressional intent to establish a comprehensive scheme of regulation of discretionary commodities futures trading accounts under the CEA, 7 U.S.C. §§ 1-24, thus operates as a bar to the judicial expansion of the jurisdictional scope of the federal Securities Acts.

The decision below, holding that Petitioner's discretionary commodities futures trading account is not a "security" within the meaning of 15 U.S.C. § 77b(1), nor subject to registration under section 5 of the federal Securities Act of 1933, 15 U.S.C. § 77e(c), is plainly correct. Both *Daniel, supra,* and *Marine Bank, supra,* by pragmatically

defining the word "security" have dampened an overly broad application of the Securities Act of 1933. By referring to so called "modern finance theory", Petitioner attempts to erode well established principles of federal Securities Laws. The Securities Act of 1933 should not be used as a tool to reach instruments not "within the ordinary concept of a security". H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933); *quoted in Marine Bank, supra,* 102 S.Ct. at 1223, *United Housing Foundation, Inc. v. Forman* 421 U.S. 837, at 849-850 (1975). SEC registration of discretionary commodities futures trading accounts does not advance the interests of the investor, but merely serves as an unjustified duplication of efforts under the federal scheme of regulation.

3. There Is No Common Enterprise in This Case

The decision below, holding that Petitioner's discretionary commodities future trading account was, as a matter of law, not a "security" under the Securities Act of 1933, 15 U.S.C. § 77(b), because there was no "common enterprise" is entirely consistent with, is indeed compelled by, an entire line of United States Supreme Court cases.

The term "security" is defined in section 2(1) of the 1933 Securities Act, 15 U.S.C. § 77b(1), to mean, *inter alia,* any "investment contract". The classic test in determining whether a particular financial relationship constitutes an investment contract was formulated by this Court in *SEC v. W.J. Howey, Co.,* 328 U.S. 293, 301 (1946): "[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." This test is to be applied in light of "the substance—the economic realities of the transaction —rather than the names that may have been employed by the parties." *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 851-852, (1975). *Accord, Tcherepnin v. Knight,* 389 U.S. 332, 336, (1967); *Howey, supra,* 328 U.S.,

at 298. *Cf. SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 80 (1959) (Brennan, J., concurring) ("[O]ne must apply a test in terms of the purposes of the Federal Acts . . . .")

In *Forman, supra*, this Court observed that the *Howey* test, "embodies the essential attributes that run through all of the Court's decisions defining a security". 421 U.S., at 852. This Court restated that "the touchstone [of an investment contract] is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." (bracketed material added) *Id.*, 421 U.S. at 852.

In every decision of this Court recognizing an "investment contract" as a "security" under the Securities Act there has always been the element of a "common enterprise." *See e.g. SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, (1943) (land and participation in a common oil exploration enterprise) *SEC v. W.J. Howey*, 328 U.S. 293, (1946), (units of a citrus grove development coupled with a common service contract for cultivating, marketing and remitting net proceeds to the investor); *SEC v. Variable Life Ins. Co.*, 359 U.S. 65, (1959) (variable annuity contract which entitled purchasers to pro rata participation in a common investment portfolio); *Tcherepnin v. Knight*, 389 U.S. 332, (1967) (bank capital stock with voting rights and dividends dependent upon profits from money lending operations); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, (1967) (variable component of mixed variable and fixed annuity contract). Even in those cases wherein the interest acquired had intermingled security and nonsecurity aspects, the interest obtained had "to a very substantial degree, elements of investment contracts . . ." *Variable Annuity Life Ins. Co., supra*, 359 U.S. at 91, (Brennan, J., concurring).

Under the *Howey* test, the critical factor in the instant case is the lack of a common enterprise.

The courts have adopted two conflicting approaches in defining the common enterprise element of the *Howey* test. They have expressed the two approaches in terms of either "horizontal" or "vertical" commonality. The terms refer to the nature of the investment relationship required to satisfy the common enterprise element. In the Third, Sixth and Seventh circuits, only "horizontal" dependence among the investors will satisfy common enterprise. See, *e.g., Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216 (6th Cir. 1980), *aff'd on other grounds*, ... U.S. ..... 102 S.Ct. 1825 (1982); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977); *Wasnovic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D.Pa. 1972), *aff'd.*, 491 F.2d 752 (3rd Cir., 1973), *cert. denied*, 416 U.S. 994 (1974); *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972), *cert. denied*, 408 U.S. 887. However, the Fifth, Eighth and Ninth Circuits satisfy the common enterprise requirement upon finding the presence of "vertical" dependence between an investor and the promoter. *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974); *Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414 (8th Cir. 1974); *Booth v. PB Company Commodities Services*, 430 F.2d 132 (CA-8 1970); *Brodt v. Bache & Co.*, 595 F.2d 459 (9th Cir. 1978).

A. Horizontal Commonality

The horizontal approach focuses on the relationship among investors. Under the horizontal approach, the success or failure of one investor must be dependent upon the success or failure of his promoter's other investors. The leading case embodying this approach is *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972), *cert. denied*, 408 U.S. 887, holding that a discretionary commodities account did not state a claim for the sale of an unregistered security:

> We find the element of commonality absent here. Although the Complaint does allege that Nelson entered into similar discretionary arrangements with other customers, the success or failure of those other contracts had no direct impact on the profitability of plaintiffs' contract. Nelson's various customers were represented by a common agent, but they were not joint participants in the same investment enterprise. *Id.*, 457 F.2d. at 276-277.

The *Milnarik* reasoning and results have been followed in a substantial line of cases involving discretionary commodities accounts. *See, Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216 (6th Cir. 1980), *aff'd on other grounds*, ... U.S. ....., 102 S.Ct. 1825 (1982); *Wasnovic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D. Pa. 1972), *aff'd.*, 491 F.2d 752 (3rd Cir., 1973), *cert. denied*, 416 U.S. 994 (1974); *Hirk v. Agri-Research Council Inc.*, 561 F.2d 96 (7th Cir. 1977).

Several courts following the horizontal approach have held that a pooling of the investors' funds constitutes horizontal commonality. See e.g., *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra*, 622 F.2d at 222; *Meredith v. ContiCommodity Serv., Inc.*, 2 COMM.FUT.L. REP. (CCH) ¶ 21,107 at 24,462 (D.D.C. Nov. 24, 1980); *Wasnovic v. Chicago Board of Trade, supra*, 352 F.Supp. at 1069. In addition, at least two courts have held that the promoter must actually pool the funds rather than merely treat each investor's funds similarly. *See Hirk v. Agri-Research Council, Inc., supra*, 561 F.2d at 101; *Meredith v. ContiCommodity Serv., Inc., supra*, 2 COMM.FUT.L.REP. (CCH) ¶ 21,107 at 24,462-63.[3]

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[3]It should be noted that, at page 3 of Petitioner's Petition for Certiorari, in the Statement of the Case, the assertion that all accounts managed by UCA were traded uniformly based on computerized signals is not supported by a reference to the record or appendices.

The roots of the horizontal approach are found in *SEC v. W. J. Howey, Co.*, 328 U.S. 293, (1946). In *Howey*, the fruit which the citrus trees yielded was collectively brought to market and sold. The proceeds were shared by the investors in proportion to the number of citrus trees a particular investor owned and not the yield of the individual trees situated on his land. As this Court noted in *Howey, supra,*:

> "Without the consent of the company, the land owner or purchaser has no right of entry to market the crop; thus there is ordinarily no right to specific fruit. The company is accountable only for an allocation of the net proceeds upon a check made at the time of picking. All the produce is pooled by the respondent companies, which do business under their own names." 328 U.S. at 296.

Consequently, the fortunes of the investors were linked to each other through the success or failure of a single venture, the marketing of the harvested citrus. Under these circumstances a common enterprise was found to exist.

Further support for the horizontal approach can be found in this Court's recent decision in *Marine Bank v. Weaver*, ... U.S. ....., 102 S.Ct. 1220 (1982). In *Marine Bank*, this Court discussed factors relevant in determining whether a "security" exists under the federal Securities Acts. Among other things, this Court stated that the instruments found to be securities involved "offers to a number of potential investors", *Id.*, 102 S.Ct. at 1225, and were ones in which there was "common trading". The decision in *Marine Bank*, supports the application of the horizontal standard to satisfy the "common enterprise" element of an investment contract, and appears to have rejected the vertical standard.

Respondents UCA and Kooyers respectfully submit that the horizontal approach to commonality is correct and consistent with the entire line of United States Supreme Court cases applying the *Howey* test. The decision below, holding

that the Petitioner's discretionary commodities futures trading account was as a matter of law, not a "security" under the Securities Act of 1933, 15 U.S.C. § 77b(1), because there was no "common enterprise" is plainly correct under the horizontal approach to commonality since: (1) there was no pooling of the Petitioner's account; and (2) the commodity trading advisor did not share in the profits because: (a) its fee was paid in advance each quarter and (b) the Petitioner was free to withdraw the profits.

B. Vertical Commonality

On the other hand, the Fifth, Eighth and Ninth Circuits have applied a less restrictive common enterprise standard known as "vertical" commonality. The vertical approach shifts the focus from the relationship among investors to the relationship between each investor and the promoter. There is disagreement, however, between the Circuits over the nature of the relationship between promoter and investor necessary to support a finding of vertical commonality.

(i) Ninth Circuit Approach

The Ninth Circuit, which requires only vertical commonality, has defined common enterprise as "one in which the 'fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties.'". *Brodt v. Bache & Co. Inc.*, 595 F.2d 459, 460 (9th Cir. 1979) (quoting *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 n.7 (9th Cir.), *cert. denied*, 414 U.S. 821, (1973)). Since, in a discretionary commodities account, the promoter merely furnishes investment counsel to another for a commission, and there is no direct correlation between the investor's profits and losses and the promoter's business, the Ninth Circuit has held that there is no common enterprise and it is therefore not a security. *See Brodt v. Bache & Co., Inc., supra; Mordaunt v. Incomco*, 686 F.2d 815 (9th Cir. 1982).

As the Ninth Circuit Court explained in *Brodt v. Bache & Co., Inc., supra,* 595 F.2d at 462:

> Our case comes to this. Using the classic definition of *Howey,* there existed an "investment" by the appellant, the profits from which were "to come solely from the efforts of others." The investment, however, was not in a "common enterprise." It was in commodity futures. Appellant's enterprise was a "solitary" one. His profits were shared neither with other investors nor the appellee; whether his investment flourished or perished was unrelated directly to either the general financial health of the appellee or the ability of the appellee to perform a duty, the purpose of which would be "to secure" to some extent the appellant's investment. Merely furnishing investment counsel to another for a commission, even when done by way of a discretionary commodities account, does not amount to a "common enterprise."

Applying the Ninth Circuit's approach to vertical commonality, the Petitioner's discretionary commodities futures trading account is clearly not a "security" under the Securities Act of 1933, 15 U.S.C. § 77b(1), because it lacked the element of a "common enterprise". As the Court below explained:

> . . . just as in *Mordaunt* and *Brodt,* the promoter continued to profit through commissions even as the account lost money. On the other hand, had the account been successful, the promoter would not necessarily have shared the benefits because Meyer could elect to withdraw profits as they accrued. Judged in the light of economic realities, this account was no different from those at issue in *Mordaunt* and *Brodt* and therefore does not qualify as a security within the meaning of 15 U.S.C. § 77b. (Petition for Certiorari, App. B p. A-5)

(ii) Fifth Circuit Approach

The Fifth Circuit approach to vertical commonality is clearly incorrect. *In SEC v. Koscot Interplanetary, Inc.* 497 F.2d 473, 478 (5th Cir. 1974), the Court held that the critical factor in the common enterprise test "is not the similtude or coincidence of investor input, but rather the uniformity of impact of the promoter's efforts." *In SEC v. Continental Commodities, Corp.*, 497 F.2d 516 (5th Cir. 1974), the Court interpreted the *Koscot* treatment of common enterprise as rejecting "the proposition that the pro rata sharing of profits is critical to a finding of commonality . . . and cast[ing] aspersions on the elevation of a pooling ingredient to the exalted status in the inquiries concerning a common enterprise." *Id.*, 497 F.2d at 522 (bracketed material added, citations omitted). The Fifth Circuit rephrased the "critical inquiry" as "whether the fortuity of the investments collectively is essentially dependent upon promoter expertise." *Id.* The Court then found this test satisfied in the case of a discretionary commodities trading account because "the success of the trading enterprise as a whole and customer investments individually is contingent upon the sagacious investment counseling of Continental Commodities." *Id.*

The Fifth Circuit's approach to common enterprise is so broad as to render the *Howey* test's common enterprise element redundant of the *Howey* test's additional element of an expectation of profits based solely on the efforts of another. The Fifth Circuit has shifted from the requirement of a common venture between the investor and the promoter to a requirement only of investor dependence upon promoter expertise. *SEC v. Continental Commodities Corp., supra*, 497 F.2d at 522-23. The *Howey* test concerns, however, as a distinctly separate element a correlation between the investor's expectation of profits and the efforts of the promoter. By its interpretation of the *Howey* test,

the Fifth Circuit has effectively eliminated the common enterprise element.

The Fifth Circuit approach to vertical commonality is so broad as to include agreements that clearly are not a security. For example, the agreement in *Marine Bank*, 102 S.Ct. 1220 (1982), which gave the guarantors 50% of the corporation's net profits would fit the Fifth Circuit's definition of a security. "[T]he agreement gave the Weavers a share in the profits of the slaughterhouse which would result from the efforts of the Piccirillos." *Marine Bank v. Weaver, supra,* ..... U.S. ....., 102 S.Ct. at 1225. The success of the enterprise was clearly dependent upon the expertise of the Piccirillos in running the slaughterhouse. But the United States Supreme Court reached the opposite conclusion, holding that: "[a]lthough the agreement gave the Weavers a share of the Piccirillos' profits, if any, that provision alone is not sufficient to make that agreement a security." *Id.*, 102 S.Ct. at 1225. Thus the Fifth Circuit's approach to vertical commonality is clearly incorrect.

Finally, it should be noted that the Fifth Circuit's decision in *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974), was based on facts which occurred prior to the enactment of the Commodity Futures Trading Commission Act of 1974. The analysis supporting the decision in *Continental Commodities*, and the line of cases following its analysis therefore must be reappraised in terms of the present regulatory structure of the CEA.

CONCLUSION

Respondents UCA and Kooyers respectfully suggest that the Court either deny certiorari or affirm the decision below holding that the Petitioner's discretionary futures trading account was not a security required to be registered under the Securities Act of 1933. The decision below is plainly correct. Section 2(a)(1) of the CEA, 7 U.S.C. § 2, as amended by the Commodity Futures Trading Commission Act of 1974, P.L. 93-436, 88 Stat. 1389, granted the CFTC exclusive jurisdiction over discretionary futures trading accounts. Additionally, *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551 (1979), and *Marine Bank v. Weaver,* ..... U.S. ....., 102 S.Ct. 1220 (1982), bar expansion of the concept of a security in the instant case since the Petitioner was adequately protected under the comprehensive regulatory structure of the CEA. Lastly, there was no "common enterprise" in this case.

Dated: February 11, 1983

Respectfully submitted,

Richard Scott Burriss
Burriss, Lowman & Rice
Attorney for Respondents
UCA Systems, Inc. and
Gerald P. Kooyers

(Appendices follow)

Appendix A

Section 2(a)(1) of the Commodity Exchange Act, 7 U.S.C. § 2:

> . . . *Provided,* That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title: *And provided further,* That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade. . . .
>
> . . . The words "the Commission" shall mean the Commodity Futures Trading Commission established

under section 4a of this title. The term "commodity trading advisor" shall mean any person who, for compensation or profit, engages in the business of advising others, either directly or through publications or writings, as to the value of commodities or as to the advisability of trading in any commodity for future delivery on or subject to the rules of any contract market, or who for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning commodities; but does not include (i) any bank or trust company, (ii) any newspaper reporter, newspaper columnist, newspaper editor, lawyer, accountant, or teacher, (iii) any floor broker or futures commission merchant, (iv) the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation including their employees, (v) any contract market, and (vi) such other persons not within the intent of this definition as the Commission may specify by rule, regulation, or order: *Provided,* That the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession. . . .

Section 2, Securities Act of 1933, 15 U.S.C. § 77b(1):

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, preorganization certificate or subscription, transferrable share, *investment contract,* voting trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to sub-

scribe to or purchase, any the foregoing. (Emphasis added.)

Section 5, Securities Act of 1933, 15 U.S.C. § 77e(c):

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security . . .

Appendix B

COMMODITY ADVISORS
INVESTMENT ADVISORY AGREEMENT

This Investment Advisory Agreement, hereinafter referred to as the "Agreement," is made and entered into this *12** day of *August*, 19*77*, by and between UCA Systems Inc., a California corporation, hereinafter referred to as the "Advisor," and *Dale F. Meyer*, hereinafter referred to as the "Client."

WHEREAS, the Client has speculative capital for the principal purpose of investing in commodity futures contracts and has been informed and is fully cognizant of the possible high risks associated with commodity investments:

NOW, THEREFORE, in consideration of the foregoing the parties hereto agree as follows:

1. The Client shall deposit with *Thomson McKinnin Securities*, hereinafter called the "Broker," those funds and securities referred to as the "Initial Deposit," in the amount of *$40,000.00*, to be managed by the Advisor. At his sole discretion the Client may withdraw funds from his commodity accounts; provided, however, that should his withdrawals reduce his commodity equity below the Initial Deposits, as set forth above, the Advisor may at his sole discretion terminate the account. The Advisor shall be given written notice in advance of all such withdrawals.

2. The Advisor will cause commodity contracts to be bought, sold, sold short, and spread, and will have exclusive authority to issue all other necessary instructions to the Broker. All such transactions shall be for the account and risk of the Client and shall be limited by the current Commodity Trading Portfolio, a copy of which is attached

*Handwritten portions are indicated by being italicized.

hereto and incorporated herein by this reference. The Client may at any time prior to termination of this Agreement, upon written notice to the Advisor, modify the Commodity Trading Portfolio. Upon such written notice, such revised Portfolio shall be deemed to be incorporated into this Agreement. The "commodity contracts" referred to above shall be deemed to include commodity futures contracts and cash deliveries on futures contracts.

3. The Advisor's services are not deemed exclusively for the Client and the Advisor shall be free to render similar services to others.

4. This Agreement shall remain in effect until terminated by written notice of either party to the other. Such notice shall have no effect upon commitments made for the account before such termination. The management fee will not be refunded or prorated in the event of termination of the agreement. Upon termination of this Agreement, trading of the Managed Assets shall be the sole responsibility of the Client.

5. The Client's account shall be charged for all commissions or expenses arising from transactions or functions exercised in the administration of the account.

6. The Advisor will send the Client a monthly statement giving an appraisal of the account at market value.

7. This contract may not be assigned by either party without the written consent of the other.

8. In compensation for all of the services to be rendered under this Agreement, the Client agrees to pay the Advisor a quarterly fee of *6%* of the Managed Assets in advance. Managed Assets shall be valued as of the last Friday of the month (or previous trading day if markets are closed on Friday) of *February, May, August,* and *November,* and shall be deemed to include all equity in

regulated and non-regulated commodity accounts plus any securities used to meet margin requirements on any commodity trading exchange.

9. The Advisor may direct the broker to invest cash held in the Managed Commodity Account in government obligations or direct its placement in any savings and loan institution for any period of time desired by the Advisor. Additionally, the Client hereby authorizes the Advisor and the Broker upon presentation of the Advisor's monthly statement as described in Paragraph 3 above, to deduct from the cash in said account the Advisor's fee and forward the same to the Advisor.

10. The Client agrees to hold the Advisor harmless from any liability incurred by the Client in trading commodity future contracts through the Managed Commodity Account. In no event shall the commodity advisor be held responsible for any of the Client's obligations in purchasing or selling commodity future contracts or for brokerage fees connected with the same. Client acknowledges that risks are inherent in trading commodity future contracts and acknowledges that the Advisor makes no guarantees that his services will result in a profit to the Client. The Advisor will not be liable to the client for any action taken by the Advisor save for the Advisor's wilful misconduct or gross negligence in the performance of his duties under this Agreement.

11. Should any dispute arise between the Client, and the Advisor relating to this Agreement or the performance hereunder, the parties to this Agreement covenant that they will submit to arbitration said dispute and further that said arbitration will be accomplished by the Committee of Arbitration established by the rules and regulations of the Board of Trade of the City of Chicago, in particular Rule 180 and following.

12. This Agreement is subject to and will be performed in accordance with the provisions of the California Corporations Code, the rules and regulations of the Commissioner of Corporations of the State of California; appropriate statutes of the United States of America and rules and regulations of the Department of Agriculture, Commodity Exchange Authority.

13. The parties to this Agreement covenant and agree to execute all documents necessary to the performance and implementation of this Agreement.

CLIENT:
Name: *Dale F. Meyer*

Address:
7481 Rollingdell Dr.
San Jose 95129 Ca.
P.O. Box 1022
Cupertino 95014

ADVISOR:
UCA SYSTEMS INC.

by *Gerald P. Kooyers*
Gerald P. Kooyers
President

UCA SYSTEMS INC.
COMMODITY TRADING PORTFOLIO

Client understands that an initial position consists of *three* contracts or less of any of the following Commodities and that as equity increases on such initial position and subsequent additions, because of a changing contract price, additional contracts are added up to the maximum as listed below.

Commodity	Maximum Positions
Wheat	75,000 bushels
Corn	75,000 bushels
Soybeans	50,000 bushels
Soybean Oil	12 contracts
Soybean Meal	12 contracts
Silver	12 contracts
Live Cattle	12 contracts
Live Hogs	12 contracts
Copper	12 contracts
Cotton	8 contracts

CLIENT:
Name:
Dale F. Meyer
Address:
7481 Rollingdell Dr.
San Jose, 95129 CA
Date *12 Aug. 77*
P.O. Box 1022
Cupertino 95014

ADVISOR:
UCA SYSTEMS INC.

By: */s/ Gerald P. Kooyers*
Gerald P. Kooyers
President

Date *August 12, 1977*

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No. 82-1195

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

DALE F. MEYER,
on behalf of himself and
all others similarly situated,
Petitioner,

vs.

THOMSON & MCKINNON AUCHINCLOSS KOHLMEYER, INC.,
UCA SYSTEMS, INC., JAMES L. MILLER,
and GERALD P. KOOYERS

PETITIONER'S REPLY BRIEF

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UCA SYSTEMS, INC., JAMES L. MILLER,
and GERALD P. KOOYERS

PETITIONER'S REPLY BRIEF

The Briefs in Opposition submitted on behalf of Respondents in this case raise issues that may prove relevant to an ultimate disposition of the plaintiff's cause of action but are not the basis of the sole ground on which the Ninth Circuit affirmed the dismissal by the district court and the sole question presented by the petition for a writ of certiorari.

Respondents contend that under the Commodity Exchange Act the regulatory authority of the Commodities Futures Trading Commission, as successor to the Secretary of Agriculture, over such matters as the operation

of commodity exchanges, fraudulent practices by members and efforts at price manipulation, either (1) expressly precludes any application of the federal securities laws or (2) constitutes adequate grounds for interpreting the "security" definition in the latter laws as not encompassing discretionary commodity trading accounts.

The court of appeals in its decision below did not find it necessary to reach or address either contention, as its opinion makes evident. After holding, in accordance with *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, ... U.S. ....., 102 S.Ct. 1825 (1982), that the Commodity Exchange Act did not preclude the district court of subject matter jurisdiction, the court of appeals gave that act no further attention. Instead, the court held that the type of investment arrangements involved in this case could not constitute a security because one of the requisite elements was lacking: a "common enterprise", under the Ninth Circuit's version of vertical commonality. The correctness of that holding, and hence of the Ninth Circuit's approach to the problem of security definition under the Securities Act of 1933, is the only question raised by the petition for a writ of certiorari.

Both Respondents in effect concede that the Ninth Circuit's position in this case is in conflict with that of the Fifth Circuit, as Petitioner pointed out. See *SEC v. Koscot Interplanetary*, 497 F.2d 473 (5th Cir. 1974); *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974). Nor does either Respondent even attempt to reconcile the Ninth Circuit's concept of vertical commonality with the facts underlying this Court's basic decision in *SEC v.*

W. J. Howey Co., 328 U.S. 293 (1946). Under the Ninth Circuit test there could be no security in *Howey*, which is hardly what this Court held.

What Respondents do wish to argue, of course, is that the decision below is correct. That will be a matter for the briefs on the merits, if the writ is granted. At this stage, Petitioner seeks only to establish that the question of the proper definition and coverage of the federal securities laws is an extremely important one that it would be timely to address, and that the present state of the law in this area is in conflict and disarray. Those propositions seem to Petitioner to be hard to deny, and neither Respondent undertook to rebut them.

For the reasons stated in the petition and this reply brief, the petition for a writ of certiorari should be granted.

Respectfully submitted.

KENNETH SCOTT
THOMAS M. BOEHM
Attorneys for Petitioner